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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BY HAND

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Rate Regulation
MM Docket No. 93-215

Dear Mr. Caton:

Please find attached on behalf of the National Association of Telecommunications Officers and Advisors, et al., an original and eleven copies of the Reply Comments of the National Association of Telecommunications Officers and Advisors, et al., in the above-referenced proceeding.

Any questions regarding the submission should be referred to the undersigned.

Sincerely,



Bruce A. Henoch

Attachment

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Implementation of Sections
of the Cable Television
Consumer Protection and
Competition Act of 1992

Rate Regulation

MM Docket No. 93-215

**REPLY COMMENTS OF THE
NATIONAL ASSOCIATION OF TELECOMMUNICATIONS
OFFICERS AND ADVISORS, THE NATIONAL
LEAGUE OF CITIES, THE UNITED STATES
CONFERENCE OF MAYORS, AND THE NATIONAL
ASSOCIATION OF COUNTIES**

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Dated: September 14, 1993

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TABLE OF CONTENTS

SUMMARY	(ii)
I. INTRODUCTION	1
II. DISCUSSION	3
A. The Commission Should Require Operators to Make a Significant Threshold Showing Before They are Permitted to Make a Cost-of- Service Showing	3
B. Excess Acquisition Costs Should be Excluded from the Rate Base	5
C. Special Rules Governing Affiliate Transactions are Needed to Prevent Operators from Recovering Inflated Costs	6
D. The Commission Should Not Implement Sweeping Exemptions for Small Systems	7
E. Lobbying Costs, Charitable Contributions and Membership Fees Should Not be Recoverable Expenses	10
F. Cable Operators Should Not be Permitted to Select Benchmark Rates on One Tier and Cost-of-Service on Another	11
III. CONCLUSION	12

SUMMARY

The Commission should implement a threshold requirement before operators are permitted to make cost-of-service showings. The benchmark and price cap system is intended to be the primary method of setting rates, and a threshold requirement is needed to ensure that cost-of-service remains a rarely-used "backstop". Cost-of-service showings are a tremendous administrative burden on all parties involved; they should be reserved for those operators that are truly faced with extraordinarily high costs that render them unable to cover their costs without higher rates.

Further, the Commission should prohibit the recovery of certain costs that should not be borne by subscribers in the form of higher rates. First, excess acquisition costs should be excluded from the rate base, as they are based almost exclusively on the expectation of monopoly profits. Second, special rules governing affiliate transactions are needed to ensure that subscribers do not pay higher rates for artificially inflated costs. Third, lobbying costs, charitable contributions and membership fees should not be recoverable expenses, as they are not connected with the delivery of regulated cable service.

In addition, the Commission should not adopt sweeping exemptions for small systems. If the

Commission does adopt a small system exemption, however, it should craft the definition of small system in a way that excludes systems with high rates of return and systems that are owned by large MSOs.

Finally, the Local Governments continue to support the Commission's tentative conclusion that operators should be required to elect either the benchmark or the cost-of-service approach for all regulated tiers; this rule is necessary to prevent operators from "gaming" the rate regulation procedures.

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FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Implementation of Sections
of the Cable Television
Consumer Protection and
Competition Act of 1992

Rate Regulation

MM Docket No. 93-215

TO: The Commission

**REPLY COMMENTS OF THE
NATIONAL ASSOCIATION OF TELECOMMUNICATIONS
OFFICERS AND ADVISORS, THE NATIONAL
LEAGUE OF CITIES, THE UNITED STATES
CONFERENCE OF MAYORS, AND THE NATIONAL
ASSOCIATION OF COUNTIES**

The National Association of Telecommunications Officers and Advisors, the National League of Cities, the United States Conference of Mayors, and the National Association of Counties (collectively, the "Local Governments") submit these Reply Comments in the above-captioned proceeding.

I. INTRODUCTION

On July 16, 1993, the Federal Communications Commission ("FCC" or "Commission") released a Notice of Proposed Rulemaking in this proceeding to solicit comments on regulatory requirements to govern cost-of-service

showings by cable operators.¹ In their Comments, the Local Governments urged the Commission to adopt rules that would ensure that cost-of-service showings remain a rarely-used "backstop" to the benchmark/price cap system, the primary method of rate regulation. Cost-of-service showings should be allowed only under extraordinary circumstances, where, due to unique conditions, the cable operator has demonstrated that application of the benchmark and price cap method of rate regulation would not ensure the continued viability of an efficiently-operated cable system.

A number of commenters, however, favor rules that, if implemented, could have the effect of undermining the benchmark system. First, the Commission should reject the suggestion of several parties that there should be no procedural bars or limitations before an operator is permitted to introduce a cost-of-service showing. Second, excess acquisition costs should be excluded from the rate base. Third, the Commission should implement special rules dealing with transactions between operators and affiliated entities that will prevent operators from seeking to justify higher rates based upon artificially inflated costs. Fourth, the Commission should reject the suggestion

¹ Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, FCC 93-353 (adopted July 15, 1993) ("NPRM").

of several parties that are in favor of sweeping exemptions for small operators. Fifth, the Commission should adhere to its tentative conclusion that lobbying expenses, charitable contributions, and membership fees and dues should not be recoverable expenses. Sixth, Local Governments continue to support the Commission's conclusion that operators should not be able to "game" the rules by choosing benchmark rates on one tier and cost-of-service on another.

II. DISCUSSION

A. The Commission Should Require Operators to Make a Significant Threshold Showing Before They are Permitted to Make a Cost-of-Service Showing.

Several parties stated in their comments that it is not necessary for the Commission to employ a threshold requirement for operators seeking to make a cost-of-service showing.² For example, Media General bases its opposition to a threshold requirement on the unsupported belief that the Commission is not in possession of sufficient knowledge to allow it to structure the rules in such a way that would "exclude only those with no prospect for prevailing in the full cost-of-service showing."³ Media General argues that

² See comments of Media General Cable of Fairfax County, Inc., filed August 25, 1993, at 2-3 ("Media General"); comments of Cable TV of Georgia Limited Partnership, et al., filed August 25, 1993, at 7 ("CATVGA"); and comments of the California Cable Television Association, filed August 25, 1993, at 17-19 ("CCTA").

³ Media General at 3.

the Commission should give operators complete discretion as to whether cost-of-service showings should be made, and that the Commission should not require a threshold showing.

These arguments should be rejected. Cable operators do not have an automatic right to make cost-of-service showings. Indeed, consistent with the 1992 Act's directive to limit the administrative burden of cable rate regulation, the Commission carefully balanced the interests of subscribers and cable operators when it established the benchmark and price cap system, and it intended for that method to be the primary mechanism for setting rates. Cost-of-service showings are designed to be a "backstop" to the benchmark method, to be used only in unique and extraordinary circumstances.

Unless the Commission implements a threshold showing that weeds out operators that do not meet these criteria, the benchmark and price cap method will be rendered totally meaningless. It is not enough that an operator may have a chance of prevailing in a showing; without a threshold requirement, the Commission would open the floodgates to hundreds or thousands of frivolous or unfounded showings by operators willing to take their chances that they might be able to justify rates above the benchmark. Cost-of-service showings are a tremendous administrative burden on all parties involved; they should be reserved for those operators that are truly faced with extraordinarily high

costs that render them unable to cover their costs without higher rates.⁴

B. Excess Acquisition Costs Should be Excluded From the Rate Base.

The Local Governments support the position of the many commenters who urge the Commission to exclude excess acquisition costs from the rate base.⁵ Excess acquisition costs are based almost entirely on the expectation of monopoly profits, and cable subscribers should not bear such costs in the form of higher rates. The comments of Arlington County, Virginia, are particularly telling. According to the County, the Arlington and Montgomery County systems are being purchased for a total of \$650,000,000, and the County fears that, if excess acquisition costs are included in the rate base, Arlington County subscribers will be penalized with higher rates than subscribers in other jurisdictions solely because of the

⁴ See comments of Arlington County, Virginia, filed August 25, 1993, at 2 ("Arlington") ("Operators should not be allowed to choose the most profitable option."); and comments of the City of Seaford, Delaware, filed August 25, 1993, at 6 ("Seaford") (Cost-of-service "should be used only in very limited circumstances, since it will produce higher rates at greater cost and effort than those permitted under the benchmark system.").

⁵ See Seaford, at 11; Arlington at 1; comments of the Connecticut Department of Public Utility Control, filed August 25, 1993, at 2; comments of Economic and Technical Consultants, Inc., filed August 25, 1993, at 4; comments of Austin, Texas, *et al.*, filed August 25, 1993, at 8; and comments of Consumer Federation of America, filed August 25, 1993, at 3 ("CFA").

excessive purchase price of the system. The price an operator is willing to pay for a cable system is a decision based on the business judgment of the operator, and reflects an analysis of the potential value of the entire cable system and infrastructure, not just basic and expanded service. The Commission cannot allow subscribers to basic and expanded service to bear these excess costs through higher rates for such services.

C. Special Rules Governing Affiliate Transactions are Needed to Prevent Operators from Recovering Inflated Costs.

A number of commenters oppose the Commission's tentative conclusion that it should adopt special rules governing the recovery of costs resulting from transactions with affiliated entities.⁶ Local Governments join several other parties in agreeing with the Commission that such rules are necessary.⁷ Given the nature of cost-of-service showings, cable operators have an enormous incentive to show high costs wherever possible; the potential for cost

⁶ See comments of National Cable Television Association, filed August 25, 1993, at 42 ("NCTA"); comments of Viacom International, Inc., filed August 25, 1993, at 57-59 ("Viacom"); Joint Comments of Cablevision Industries Corporation, et al., filed August 25, 1993, at 57-60; and comments of Discovery Communications, Inc., filed August 25, 1993, at 4-5.

⁷ See CFA at 7; Seaford at 13; comments of Bell Atlantic, et al., filed August 25, 1993, at 17-18 ("Bell Atlantic"); and comments of Michigan Ad Hoc Committee for Fair Cable Rates, filed August 25, 1993, at 20-21.

inflation is especially high given the preponderance of vertically integrated companies.

Viacom and NCTA claim that special affiliate transaction rules are not needed because there is no history of abuse in this area. Local Governments believe that this argument rings hollow. The opportunity for abuse is tremendous because of the operator's need to show high costs in cost-of-service showings and the control the operator or its affiliate exerts over intra-company transactions.

Affiliate transaction rules are currently in place for common carriers.⁸ See Bell Atlantic at 18. Local Governments believe that application of similar rules to cable operators in cost-of-service showings would place a minimal burden on operators, yet would protect subscribers from having to pay higher rates based on phantom higher costs.

D. The Commission Should Not Implement Sweeping Exemptions for Small Systems.

A number of commenters have urged the Commission to adopt an exemption for small systems, although the commenters differ as to the scope of the exemption and the definition of the systems to which the exemption will

⁸ See 47 CFR § 32.27 (1992).

apply.⁹ As they discuss in their initial comments, the Local Governments believe that small systems should not be singled out for preferential treatment. By providing exemptions and benefits to small systems, the Commission would be lessening the protection from higher rates afforded to small system subscribers. Further, many small systems -- those with 1,000 subscribers or less -- are often systems that earn high rates of return, and such systems are frequently affiliates of large MSOs that enjoy access to vast resources.

If the Commission does decide to adopt some form of rules governing cost-of-service showings for small systems, Local Governments urge the Commission to craft the rules in such a way that only small systems that are truly in need of special rules are able to utilize them. "Small system" should be defined in a way that excludes systems with high rates of return and systems that are owned by large MSOs. The Small Business Administration proposes a definition of small system that would include all systems owned by operators with total gross revenues from all systems owned of less than \$7.5 million. While we support in concept the SBA's effort to limit the exemption to systems that are not

⁹ See, e.g., CCTA at 72-75; comments of Prime Cable, et al., filed August 25, 1993, at 37; comments of Tele-Media Corporation, filed August 25, 1993, at 19; and comments of the Chief Counsel for Advocacy of the United States Small Business Administration, filed August 25, 1993, at 14-17 ("Small Business Administration" or "SBA").

affiliated with large MSOs, the definition it proposes would not accomplish this goal. A total gross revenue cap of \$7.5 million would encompass systems owned by the operator with a total of between 20,000 and 25,000 subscribers.¹⁰ If this definition were adopted, even an operator that owned a single system with 20,000 subscribers would qualify for special treatment.

The Commission should instead define a small system as any stand-alone cable system (including all headends of such system) that serves a total of 1,000 or fewer subscribers in the franchise area(s) in which it provides service; except that the rules should not apply to a cable system that: (i) serves a total of more than 1,000 subscribers in multiple franchise areas, even if one or more of the franchise areas has fewer than 1,000 subscribers; or (ii) is directly or indirectly owned by a cable operator that directly or indirectly owns other cable systems, and the cable systems directly or indirectly owned by such a cable operator serve a total of 45,000 or more subscribers.¹¹ Use of this definition would ensure that systems owned by large MSOs are not be able to benefit from

¹⁰ Small Business Administration at 15.

¹¹ This definition has been proposed by the Local Governments in previous proceedings. See, e.g., comments of the National Association of Telecommunications Officers and Advisors, et al., in Docket No. 92-262, filed January 13, 1993, at 16.

an exemption designed to reduce the burdens on small independently-owned systems.

E. Lobbying Costs, Charitable Contributions and Membership Fees Should Not be Recoverable Expenses.

Cable TV of Georgia in its comments disagrees with the Commission's tentative conclusion that certain expenses such as lobbying, charitable contributions, membership fees and other similar expenses should be excluded from recoverable operating expenses.¹² CATVGA argues that such expenses are "just as much a part of running a business as other direct costs of providing service."¹³ The Local Governments strongly oppose this position. Any costs that are recoverable in a cost-of-service showing will be paid for by subscribers in the form of higher rates; there is no legitimate reason for subscribers to pay for costs that are in no way connected to the delivery of regulated cable service. Lobbying costs, membership dues and charitable contributions are discretionary expenses that are made solely for the reason of advancing the operator's business interests and boosting its profits. While shareholders may choose to support the cost of athletic club memberships for company executives, or the costs of lobbying governmental officials for more favorable treatment for the operator, it

¹² CATVGA at 13.

¹³ CATVGA at 13.

would be unconscionable for subscribers to do so through higher rates.¹⁴

F. Cable Operators Should Not be Permitted to Select Benchmark Rates on One Tier and Cost-of-Service on Another.

The Local Governments support the Commission's tentative conclusion in the Third Notice of Proposed Rulemaking that operators should be required to elect either the benchmark or the cost-of-service approach for all regulated tiers.¹⁵ This requirement is necessary to ensure that operators are not able to "game" the procedures by deciding that it would be more advantageous to submit a cost-of-service showing on one tier and use the benchmark rates on another. Accordingly, Local Governments urge the Commission to reject the position taken by several commenters in this proceeding that operators should be permitted to utilize different methods on different regulated tiers.¹⁶

¹⁴ The statement by CATVGA that expenses in the community should be recoverable because cable, unlike traditional utilities, "must struggle to maintain and increase penetration in most communities" is absurd, given that cable operators in nearly every community enjoy a total monopoly on the delivery of multichannel video programming.

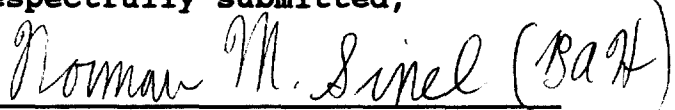
¹⁵ Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, FCC 93-428 (Adopted August 27, 1993).

¹⁶ See CCTA at 69; comments of Continental Cablevision, filed August 25, 1993, at 79; and comments of the Medium-Sized Operators Group, filed August 25, 1993, at 12.

III. **CONCLUSION**

In order to ensure that the benchmark method remains the primary method of rate regulation, the Commission should implement a threshold showing for operators before they are permitted to make cost-of-service showings. Further, the rules should be designed in such a way to prevent unreasonable or unnecessary costs from being passed on to subscribers in the form of higher rates.

Respectfully submitted,

 (BAH)

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